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February 28, 2006

John Hester
Director, Telecommunications Division
Illinois Commerce Commission
Suite C-800
160 N. LaSalle St.
Chicago, IL 60601

Re: Staff Request for Comments on the Just and Reasonable
Standard for Competitive Telecommunications Services

Dear Mr. Hester:

CUB agrees that Sections 9-250, 13-101, and 13-505 of the Illinois Public Utilities Act ("PUA") grant the Commission explicit authority to determine whether rates and rate changes for competitive telecommunications services are just and reasonable. We welcome the opportunity to comment on the use of that authority.

One thread runs throughout our comments. The Commission should initiate a rulemaking to provide guidance for future rate and rate change reviews. A rulemaking will result in more regulatory certainty for utilities, while allowing ample comment from the public and interested parties. The rulemaking should determine:

1. A threshold, above which the filing carrier must provide more detailed information,
2. Any 'trigger' mechanisms that would initiate an investigation into whether rates or a rate change is just and reasonable,
3. A standard for a *prima facie* showing that a rate or rate change is just and reasonable,

4. A list of factors that the Commission may consider when it determines whether a rate or rate change is just and reasonable, and
5. A method of estimating elasticity of demand for use in determining whether a rate or rate change is just and reasonable.

Q1. Should the Commission's decision(s) concerning whether to investigate rates for competitive telecommunications services differ according to provider types and sizes, service or product types, market conditions, service areas, or other such factors? If so, please explain how the Commission's exercise of its authority should vary across such differing factors and why.

Some services are more essential than others, and some market conditions are more conducive to abusive behavior than others. Consequently, the Commission's exercise of its authority to review rates should differ based on the type of service at issue, provider size, and market conditions. Review is especially appropriate for:

1. **Basic local telephone services.** Illinois has the fourth lowest telephone penetration rate in the nation. Consumers should have reasonably priced access to basic residential local exchange services so that they may contact neighbors, doctors, public safety officials, schools, and workplaces. Universal service funds may increase our telephone availability rate, but should not replace just and reasonable rates.
2. **Providers who have high market share.** Review is appropriate here to determine that rates are not artificially high due to a lack of robust competition in the marketplace.
3. **Markets in which conditions have changed** since the competitiveness determination in a way that may be detrimental to robust competition. For example, where the

market has experienced mergers, acquisitions, market exit, or significant changes in market share.

Q2. Should the Commission require that carriers submit information (e.g., cost studies) to assist it in determining whether to open an investigation into the justness and reasonableness of rates for competitive telecommunications services? If not, please explain.

If yes, please address (at a minimum) the following in your answer:

- a) The source of the Commission's authority to require such information.**
- b) A list of such potential information, the purpose of each item, and the circumstances under which the item should be provided.**
- c) An assessment of whether, and if so why, tariff filings that exceed certain thresholds require more detailed explanations and backup than tariff filings that do not exceed these thresholds? If yes, please provide examples of appropriate thresholds and the additional information that should be required with such a filing.**
- d) An assessment of whether the Commission should specifically impose on carriers proposing rate changes a requirement that the carrier provide *prima facie* evidence that the proposed changes yield just and reasonable rates?**
- e) An assessment of whether the Commission should require carriers to file annual demand, rate and/or other data related to their provision of competitive services including an explanation of what should be filed and under what circumstances.**

To the extent that the Commission needs information that is not readily and publicly available, it should require carriers to provide it. The Commission's authority to do so comes

directly from the explicit authority to review rates and rate changes granted by Sections 9-250, 13-101, and 13-505 of the PUA. If the Commission were not able to request the information necessary to prepare a meaningful review, then its authority to review rates would be moot. Since it is reasonable to presume that our legislators did not intend PUA to be meaningless, the Commission may wish to consider the following information when determining whether to open an investigation:

1. **Market share.** Market share information is useful to determine if market conditions have changed or if one carrier is able to exert market power. All carriers should provide this information on a regular basis.
2. **Merger, acquisition, and market exit.** This information is useful to determine whether market conditions have changed and to determine whether one carrier can exert market power. All carriers should provide this information when announcing a merger, acquisition, or market exit, and should include estimated dates of completion.
3. **Complaints.** Carriers should provide information on the number and type of complaints received on a regular basis. A sudden increase in the number or type of complaints may indicate that a rate change is unreasonable.
4. **Profit margin.** Carriers should provide this information on a regular basis so that, over time, the Commission can determine if some companies are making exorbitant profits in the long run, which would indicate a lack of robust competition.

We support efforts to conserve resources and speed reviews by requiring tariff filings that exceed certain thresholds to contain additional, detailed information. However, the Commission should employ a rulemaking proceeding to set these thresholds. A rulemaking would allow all parties sufficient time to study the issues and comment thoughtfully. Once thresholds are set,

competitive service tariff filings that exceed them should include, at a minimum, detailed market condition data such as market share and a list of competitors within the market.

We support efforts to conserve resources and speed reviews by requiring carriers to make a *prima facie* showing that proposed rate changes are just and reasonable. However, the Commission should employ a rulemaking proceeding to determine what constitutes a *prima facie* showing.

At a minimum, carriers should file annual rate information, demand, profit margins, and market share. Carriers should file this information regularly to assist the Commission in determining whether it needs to review rates.

Q3. Are there any specific factors or circumstances that might automatically “trigger” a Commission Section 9-250 investigation into whether a rate change for a competitive telecommunications service is just and reasonable? If yes, please provide an explanation or justification for each proposed trigger, an analysis of the how such a trigger would be applied, and an explanation of what information would be necessary to apply such a trigger. Examples of factors that might be incorporated into such criteria are:

- 1. markup over incremental cost;**
- 2. number of competitors providing the service;**
- 3. comparison to rates charged by competitors for similar or identical services;**
- 4. percentage increase over existing rate;**
- 5. complaints;**
- 6. discrimination;**
- 7. reasonableness of profits;**

8. **markup over fully allocated costs;**
9. **consistency with other specified statutory and/or public policy goals;**
10. **the availability of substitute services;**
11. **elasticity of demand; and**
12. **industry studies relating to the services in question.**

While there are certainly circumstances that should automatically trigger an investigation into whether rate changes are just and reasonable, the Commission should employ a rulemaking proceeding to set these triggers. A rulemaking would allow all parties sufficient time to study the issues and to comment thoughtfully. While we hesitate, without further study, to specify exact levels of the following factors that indicate improper market behavior, the Commission may use them to determine whether further review is necessary.

1. **Markup over costs.** An exorbitant markup may signal that there is a lack of robust competition in a market. Consequently, the Commission should consider the markup in determining whether to investigate.
2. **Number of competitors.** Because market conditions vary, it is difficult to identify the exact number of competitors that constitutes robust competition. However, the Commission should consider the number of competitors as one factor in determining whether to begin an investigation.
3. **Complaints.** A consistently high level of complaints, or a sharp rise in complaints, may indicate that the market is not exerting sufficient pressure on a carrier to maintain reasonable rates or service quality. To apply a trigger using complaints, the Commission should maintain a record of the number and type of complaints to the Commission, Attorney General, CUB, and the carrier's customer service agents.

4. **Discrimination.** Rates that vary across geographical areas or other variables, such as customer class, may indicate that robust competition is not exerting sufficient pressure on a carrier to maintain reasonable rates in all areas. Consequently, the Commission should consider price discrimination as one factor in determining whether to begin an investigation.
5. **Reasonableness of profits.** Robust competition precludes exorbitant long run profits. While it is difficult to identify a level of profit margin that indicates market power, the Commission should consider persistently high profit margins as one factor in determining whether to begin an investigation.
6. **Inconsistency with statutory or public policy goals.** Any inconsistency with statutory or public policy goals should serve to trigger an investigation aimed at resolving that inconsistency. CUB is particularly concerned that telephone service retain widespread affordability and high quality of service for Illinois telecommunications consumers. Illinois has one of the nation's highest percentages of households without a telephone. Consequently, rates or changes to rates that are inconsistent with PUA § 13-103(a)'s goal of telephone services that are "provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest" should trigger an investigation and Commission action.
7. **Availability of substitute services.** The lack of substitutes is a hallmark of non-competitive markets. Consequently, a lack of substitutes should trigger an investigation into whether rates are just and reasonable. Carriers who propose higher rates should provide evidence of functionally equivalent and similarly priced

substitutes. For new and technologically unique services, the Commission should monitor the introduction of substitutes over time.

8. **Elasticity of demand.** Highly inelastic demand should also serve as a trigger for review. Where demand is highly inelastic, even robustly competitive markets could result in unjust and unreasonable rates. Demand curves are difficult to estimate, however, and so the Commission should address this estimation through a rulemaking proceeding.
9. **Industry studies.** Any relevant industry studies should be considered in formulating the criteria that trigger review, and in determining whether rates or rate changes are just and reasonable.

Q4. Should the Commission investigate (through a Section 9-250 hearing) whether a rate change for a competitive telecommunications service is just and reasonable without previously determining a “just and reasonable” standard appropriate for competitive telecommunications service rates? That is, should the Commission establish criteria in a rulemaking or other “global docket” to determine whether a rate for a competitive telecommunications service is just and reasonable or should the Commission review each tariff on a case by case basis? Please explain.

The dynamic nature of the telecommunications business, need for public comment, and wide variety of relevant factors make a one-size-fits-all reasonableness standard inappropriate. Thus, the Commission should review each tariff on a case-by-case basis.

The Commission should undergo its review, however, with guidance provided by a rulemaking to determine:

1. A threshold, above which the filing carrier must provide more detailed information,
2. Any “trigger” mechanisms that would initiate an investigation into whether rates or a rate change is just and reasonable,
3. A standard for a *prima facie* showing that a rate or rate change is just and reasonable,
4. A list of factors that the Commission may consider when it determines whether a rate or rate change is just and reasonable, and
5. A method of estimating elasticity of demand for use as one factor the Commission may consider when it determines whether a rate or rate change is just and reasonable.

While the Commission should decide whether any particular rate change is just and reasonable given its particular circumstances, a comprehensive rulemaking to determine the factors and method of making this determination would simplify the process, provide regulatory certainty, and allow for thoughtful comment from the public.

Q5. Please explain how the “just and reasonable” concept is most appropriately applied to competitive telecommunications services. Please include the following in your answer:

- a) Any case law you believe to be directly pertinent or applicable.
- b) A proposed “definition” of just and reasonable - as applied to rates for competitive telecommunications services.
- c) A list of criteria that would allow the Commission to determine whether a rate for a competitive telecommunications service is just and reasonable. Please provide an explanation or justification for each proposed criterion, an analysis of the how such criteria would be applied, and an explanation of what

information would be necessary to apply such criteria. Examples of factors that might be incorporated into such criteria are:

- i) markup over incremental cost;**
- ii) number of competitors providing the service;**
- iii) comparison to rates charged by competitors for similar or identical services;**
- iv) percentage increase over existing rate;**
- v) complaints;**
- vi) discrimination;**
- vii) reasonableness of profits;**
- viii) markup over fully allocated costs;**
- ix) consistency with other specified statutory and/or public policy goals;**
- x) the availability of substitute services;**
- xi) elasticity of demand; and**
- xii) industry studies relating to the services in question.**

The Illinois courts have not frequently discussed the application of the just and reasonable standard to telephone rates. In Citizens Utility Board v. Illinois Commerce Comm'n, 277 Ill.App.3d 730, 736-37, 658 N.E.2d 1194, 1200 (1st Dist. 1995), the Appellate Court noted that the statutory duty to set just and reasonable rates required the commission to “balance the competing interests of stockholders and ratepayers.” The court observed that this balance required the Commission to take the interests of ratepayers into account “by considering the impact of proposed rates on ratepayers” and that “if the rightful expectations of the investor are

not compatible with those of the consuming public, it is the latter which must prevail.” Citizens Utility Board, 277 Ill.App.3d at 737.

Utility rates have historically been set to recover the utility’s cost of service and provide a reasonable rate of return for utility investors. The industry has been restructured, however, in the hopes of fostering competition. Rigorous competition should “substitute for regulation in determining the variety, quality and price of telecommunications services.” 220 ILCS 5/13-103(b). The PUA still requires, however, that “telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest.” 220 ILCS 5/13-103(a). Consequently, just and reasonable rates are those that mimic the price constraining pressures of a rigorously competitive market, and result in service quality and variety that is at least as high as under a regulated monopoly.

The Commission should consider the following criteria in determining whether a rate or change in rates is just and reasonable:

1. **Markup over costs.** An exorbitant markup may signal that there is a lack of robust competition in a market. Consequently, the Commission should consider the markup in determining whether a rate or rate change are just and reasonable.
2. **Number of competitors.** Because market conditions vary, it is difficult to identify the exact number of competitors that constitutes robust competition. However, the Commission should consider the number of competitors as one factor in determining whether a rate or rate change is just and reasonable.

3. **Comparison to competitor's rates.** Rates may vary for a particular service across carriers, and there may be reasonable explanations for that variation. However, the Commission should consider dramatic variations as one factor in determining whether robust competition is leading to just and reasonable rates.
4. **Percentage increase over existing rates.** The Commission should consider whether large increases over existing rates are indicative of a lack of competition or will result in unreasonable rate shock to consumers.
5. **Complaints.** A consistently high level of complaints, or a sharp rise in complaints, may indicate that the market is not exerting sufficient pressure on a carrier to maintain reasonable rates or service quality. Consequently, the Commission should consider the number and type of complaints as one factor in determining whether a rate or rate change is just and reasonable. To apply this factor, the Commission should maintain a record of the number and type of complaints to the Commission, Attorney General, CUB, and the carrier's customer service agents.
6. **Discrimination.** Rates that vary across geographical areas or other variables, such as customer class, may indicate that robust competition is not exerting sufficient pressure on a carrier to maintain reasonable rates in all areas. Consequently, the Commission should consider price discrimination as one factor in determining whether a rate or rate change is just and reasonable.
7. **Reasonableness of profits.** Robust competition precludes exorbitant long run profits. Consequently, profits significantly above the industry average for a particular service may indicate market power. While it is difficult to identify a level of profit margin that indicates market power, the Commission should consider persistently

high profit margins as one factor in determining whether a rate or a rate change is just and reasonable.

8. **Inconsistency with statutory or public policy goals.** Any inconsistency with statutory or public policy goals should serve to trigger an investigation aimed at resolving that inconsistency. CUB is particularly concerned with the widespread affordability and high quality of service for Illinois telecommunications consumers. Illinois has one of the nation's highest percentages of households without a telephone. Consequently, rates or changes to rates that are inconsistent with PUA § 13-103(a)'s goal of telephone services that are "provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest" should trigger an investigation and Commission action. Thus, the Commission should consider inconsistency with statutory or public policy goals as a major factor in determining whether a rate or rate change is just and reasonable.
9. **Availability of substitute services.** The lack of substitutes is a hallmark of non-competitive markets. Consequently, the Commission should consider a lack of substitutes as a factor in determining whether robust competition is leading to just and reasonable rates. The carrier should provide information showing that substitutes exist, when it raises rates. For new and technologically unique services, the Commission should monitor the introduction of substitutes over time.
10. **Elasticity of demand.** The Commission should also consider the elasticity of demand as one factor in determining whether rates or a rate change is just and reasonable. Where demand is highly inelastic, even robustly competitive markets could result in unjust and unreasonable rates. Demand curves are difficult to

estimate, however, and so the Commission should address this estimation through the rulemaking proceeding discussed above.

11. **Industry studies.** The Commission should consider any relevant industry study when it determines whether a rate or rate change is just and reasonable.

12. **Merger, acquisition, the creation of new affiliates, and market exit.** The Commission should also consider any market conditions that have changed since the competitiveness declaration. Mergers, acquisitions, the creation of new affiliates, and market exit are useful to determine whether one carrier can exert market power. All carriers should provide this information when announcing a merger, acquisition, or market exit, and should include estimated dates of completion.

Q6. Can the Commission rely on market forces to ensure that rates for competitive telecommunications services (as identified and specified by the PUA) are just and reasonable without abrogating its responsibility to review such rates under Section 13-505?

- a) **If yes, please identify and explain any circumstances required to make this possible.**
- b) **If no, please explain how any such circumstances can be objectively identified and measured.**

The Commission may be able to rely on market forces to ensure just and reasonable rates where the following conditions exist:

- 1. A large number of unaffiliated carriers provide the service through their own facilities in a particular geographic area.

2. The service has no health and safety or public policy implications (such as telephone usage rates and the availability of dial-up Internet access).
3. The demand curve for the service is elastic.

The Commission must investigate, however, if there is any indication, from these or other variables, that rates may not be just and reasonable.

Very truly yours,



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Citizens Utility Board